

MARSH



The Changing Face of Risk Management



Excellence in Risk Management III
An Annual Survey of Risk

Risk has always been with us. But today, it sometimes comes in strange new shapes that the risk management practitioners of 15 years ago would hardly have recognized.

Back then, risk management concerned itself primarily with such issues as roofs caving in from ice and snow and customers slipping and falling in the lobby. Today, its practitioners are more likely to lie awake wondering what would happen if the overnight package containing 40,000 credit cards were to disappear.

But risk is not just different; it has been supersized. Although hurricanes have always been capable of striking fear into shorefront dwellers, the rapid development of coastlines over the past several decades has increased the potential for damage. Now, they can devastate a Gulf Coast metropolis—killing hundreds of people, bringing shipping to a halt, uprooting whole communities, and causing billions in property damage and economic loss. And although the tragedy of September 11, 2001, is receding in time, many large companies are still coming to grips with the now-implicit threat of terrorism in many areas of their operations—routing goods through a single large transit hub, processing transactions in one or two data centers, having high concentrations of employees, and so on.

Another factor propelling these shifts in risk management's focus is pressure from investors, rating agencies, securities analysts, regulators—in short, the wide array of interested parties outside the organization that monitors its performance from day to day, parties for which risk management is becoming a much higher agenda item.

The next few years are shaping up as a critical period for risk management as a practice and a profession. The new and far broader portfolio of risks is fraught with opportunity—the opportunity to take on these new issues proactively; to help management and the board devise solutions; and in so doing, to infuse a new way of thinking about risk into the company’s leadership. Counterbalancing the opportunity, though, is the potential pitfall of staying in the traditional comfort zone of risk management—identifying insurable risks, purchasing insurance, analyzing claims, and seeing to a myriad of administrative details.

To find out how risk managers are responding to this new world of risk and where they see themselves going in the future, the Risk and Insurance Management Society (RIMS) and Marsh jointly crafted and sponsored a quantitative survey of RIMS members to determine the current state of risk management. Greenwich Associates, a premier strategic-consulting and research firm for providers and users of financial services worldwide, conducted the survey. The results were presented as part of the “Excellence in Risk Management III” session at the RIMS 2006 Annual Conference & Exhibition in Honolulu. We offer our sincere thanks to the nearly 900 RIMS members who took part in the survey.



Michael Liebowitz
President, RIMS



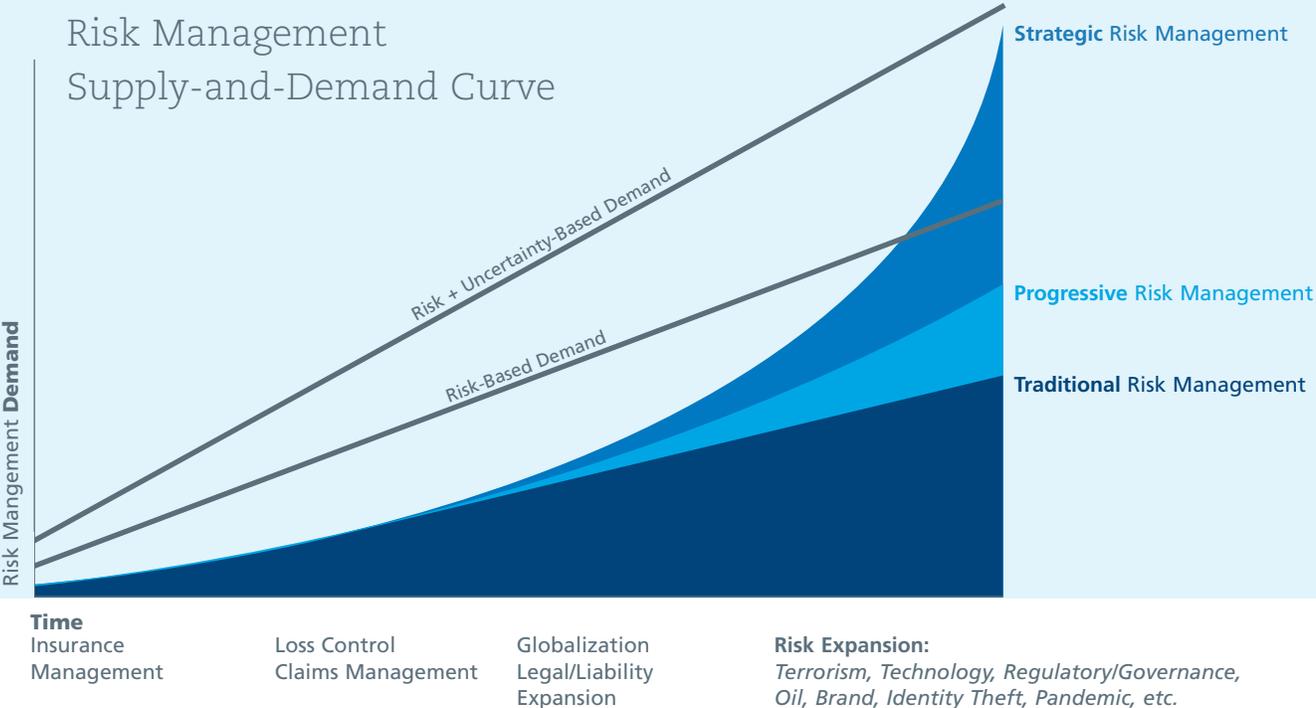
Timothy J. Mahoney
CEO of Americas and G5, Marsh

Risk Management Supply and Demand

The risk environment continues to evolve. New categories have materialized in the past decade, many of them more difficult to quantify than “traditional” property and casualty risks, both in terms of their frequency and their severity. And yet, the “old” risks have not gone away. Instead, the demands on risk management have expanded as the world has become more complex, more interdependent, and more risky. Risk managers are faced with an increasing number of nontraditional challenges. And over time, we have also seen the role of risk manager and its impact expand in some organizations to fill the demand for risk management leadership.

One way to look at the totality of the risk environment organizations face is to break it down into the known, the unknown, and the unknowable. Who among us, 50 years ago, could have envisioned information about more than 100,000 people being stored on a tiny piece of plastic? Who would have guessed that two solidly built skyscrapers could be brought down by two airplanes (or that anyone would even try to do so)? Risk management must not only deal with the known risks; but also the unknown and the unknowable. These are now concerns of risk management, but the degree to which a given risk manager deals with some of these risks depends on the level of risk management at which he or she operates.

As the chart on this page demonstrates, risk-based demand for risk management is expanding. Beyond these new but known risks, however, the uncertainty factor looms. Today’s risk managers can only meet these demands if they operate at a strategic level. They need not only to manage known risks, but also to be prepared to cope with unknown risks that may manifest themselves at any time.



Levels of Risk Management

The *Excellence in Risk Management III* survey results indicate that risk practitioners fall into three different categories: traditional, progressive, and strategic. This may be a function of the risk practitioner's skill set, the organization's risk management supply and demand, or a combination of these and other factors.

The survey of nearly 900 risk management professionals clearly shows functions and best practices at each of these three levels, as indicated below.

Traditional Risk Management

- Risk Identification
- Loss Control
- Claims Analysis
- Insurance and Risk-Transfer Methods

Traditional risk management involves many long-established, routine functions. These include identifying risk, using various risk-control measures to eliminate or mitigate loss, analyzing claims and claims trends, and handling the details of insurance and other risk-transfer methods.

Progressive Risk Management

Traditional +

- Alternative Risk Financing
- Business Continuity
- Total Cost of Risk
- Education and Communication

Progressive risk management encompasses all of the concerns of traditional risk management, but adds alternative risk financing (such as self-insurance, captives, and risk-capital products), business-continuity planning, measurement of the total cost of risk (TCOR), and education of and communication with the rest of the organization about risk and its management.

Strategic Risk Management

Traditional +

Progressive +

- Enterprise-wide Risk Management
- Indexing of Risk
- Use of Technology

Strategic risk management goes further still, incorporating all of the areas that fall in both traditional and progressive risk management, but adding the C-suite view of the totality of risk. The practitioner of strategic risk management views risk as something to optimize, not just to mitigate or avoid, taking an enterprise-wide view of risk. Risk is indexed against the organization itself, year-over-year, and against competitors. And risk management information systems (RMIS) and other technologies play a large role in managing risk.

These three levels of risk management—traditional, progressive, and strategic—are the perspective from which we examine risk and how it is being managed in different organizations throughout the remainder of this report.

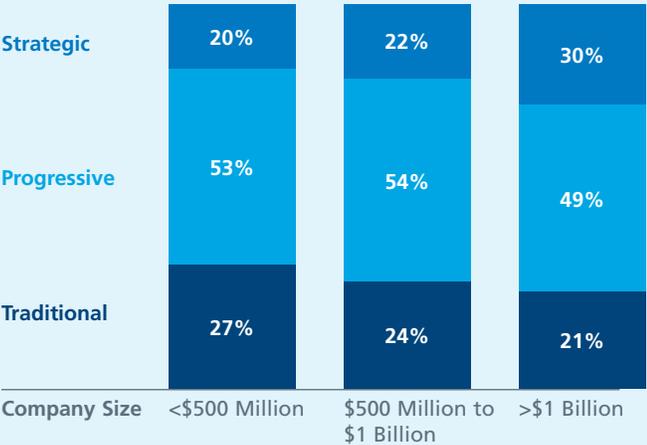
The different levels of risk management led us to question why some risk managers operate at a strategic level, while others do not. We ran correlation analyses based on a number of factors. Some of the correlations between a strategic level of risk management and other data elements were not surprising. For example, strategic risk management showed a strong correlation with:

- risk management as a key priority for the firm;
- regular review of risk management issues;
- sufficient resources allocated to manage risk effectively;
- significant impact of the Sarbanes-Oxley Act; and
- solid understanding by senior management of the risks the firm faces.

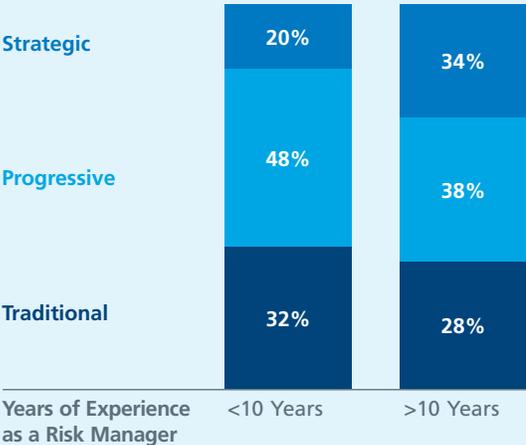
There were other data elements with which we expected a strong correlation, but did not find one. For example, there was a weak correlation with:

- the size of the company;
- prior experience with a sizable loss; and
- the risk manager's number of years in the risk management profession.

Company Size Versus Level of Risk Management



Years of Experience Versus Level of Risk Management



It is important to remember that at every level—traditional, progressive, and strategic—the risk management practitioner adds value to the organization, but there is an evolutionary process. Like Maslow’s hierarchy of needs—which suggests that humans fulfill basic needs first, then build toward self-actualization—the core competencies of traditional risk management form the basis and support the ability to move into such progressive and strategic risk management areas as crafting more creative risk-financing programs, understanding and using TCOR concepts, and implementing enterprise risk management (ERM). This points to the conclusion that a more strategic approach to risk management is enabled by organizational philosophy and thinking and is not necessarily limited by size, resources, or experience.

The Risk Comfort Zone

The growing and changing risk environment faced by virtually all companies suggests that the demand for risk solutions continues to grow. Someone must step into this role and assume responsibility for filling the growing gap in the risk management supply/demand curve.

At some companies, the risk manager could become that person, one of a small group of corporate officers known to possess a 360-degree view of how the firm operates and what challenges it faces.

However, the majority of risk managers in the survey expressed a level of discomfort with certain nontraditional risks—the risks that were outside of their normal areas of operation and expertise. The *Excellence in Risk Management III* survey asked risk managers for their reaction to 19 areas of risk, both in terms of the importance of the risks and their comfort level with handling those risks. The following graph illustrates both the importance and the comfort level in the risk managers' views.

Comfort Level With and Importance of Risks



The upper right-hand quadrant shows those risks that risk managers view as high in importance, but with which they are not all that comfortable. Not surprisingly, these risks could be characterized as nontraditional, but are areas that require close attention and an action plan to address them:

- brand risk;
- business continuity/crisis management risk;
- enterprise risk;
- human capital;
- intellectual property; and
- technology/e-risk.

In the lower right-hand quadrant are risks also viewed by risk managers as high in importance, but with which they have a high comfort level. Again not surprisingly, these are all risks for which the insurance industry has had insurance products available for decades. They are the “bread and butter” of traditional risk management:

- auto;
- environmental;
- general liability;
- products liability;
- property;
- regulatory/compliance; and
- workers compensation.

In order to progress to being a strategic member of a firm’s decision-making team—the risk management expert for known, unknown, and unknowable risks—risk managers must step outside their comfort zones.

The good news is that good risk management endows its practitioners with assets that can help them take advantage of the opportunities that the new risk environment offers.

Good risk management requires communication skills and an ability to establish close ties in many different parts of the organization. The traditional focus on companywide financial and hazard issues imparts an ability to understand how critical parts of the company work on a detailed level.

Broader Skill Sets

Risk managers must widen their perspectives and develop broader skill sets. They must develop a full-spectrum knowledge of the company, not just a narrow range of what are traditionally understood as risks. This is essential if information about a serious new threat to the organization—be it a supply-chain vulnerability or a collapse in a key information firewall—is to be communicated up from the risk manager to the C-suite instead of communicated down from senior officers demanding to know why they were not told about it.

To ensure that this flow of information moves in the right direction, the risk manager must achieve a comfort level with every major aspect of the company's operations. He or she must be able to converse intelligently with the company's financial executives about financial matters, marketing executives about marketing issues, operations executives about operational matters, and so on—and on any of these topics and more with the CEO, the CFO, and/or board members.

Enhanced Risk Communication



The specifics of risk management will vary dramatically from company to company and from industry to industry. New health risks may affect pharmaceutical companies more directly than financial services firms. Some industries will be able to outsource some business functions more aggressively, while others are constrained to keep more of them in-house.

Greater familiarity and fluency with financial matters will be especially important. Despite the magnitude of the new generation of risks, investors today focus obsessively on short- to medium-term financial performance and are increasingly intolerant of “surprises”—even when they can be chalked up to hard-to-plan-for crises. Regardless of the

source of disruption, investors—and other stakeholders—are looking for businesses to return to business as quickly as possible. In an increasingly global corporate culture, this means the risk manager must be able to communicate fluently with executives doing similar jobs, even when those executives are in countries that vary in their practices in subtle—or not-so-subtle—ways.

To succeed requires greater “soft” diplomatic skills—the ability to say politically incorrect things in a politically correct way—than risk managers have been required to possess in the past. Those most likely to acquire these skills are risk managers who spent significant time early in their careers working in other areas of the company—internal audit, financial analysis, operations, customer service, and so on. They must know how to speak the language of these areas and develop strategic relationships within them. But that does not mean that more experienced risk managers who have not made the rounds of the company cannot gain these skills; it may just require more effort.

Risk management will continue to administer relationships with insurers as in the past, but the future of risk management as a profession is in a broader marketplace where leadership thus far has come largely from outside the risk management profession. Good, effective risk management will mean directly influencing the decisions—and changing the behavior—of senior management in an area where it is not always inclined to focus its attention.

Those who apply themselves to understanding the new risk environment and finding solutions to the challenges it poses—who become change agents, not just caretakers—will gain the leverage to add value within the organization. That will enable them to help leadership make informed risk decisions and, thus, to exercise leadership themselves.

The Risk Manager and the New Skill Sets

“Risk managers need to navigate through an increasingly wide array of new risks, requiring broader skill sets. New risks like terrorism, pandemics, energy, and supply-chain shocks are coming out of the woodwork; and management is looking for answers. Ability to communicate in simple language across functions and cultures on the potential of nontraditional risks, as well as handle the traditional world of hazard risk and insurance, is the key to success.”

— Quote from one of the risk managers involved in the *Excellence in Risk Management III* survey

A New Generation of Risks

Behind these new—and newly perceived—risks are a series of shifts in the way companies do business that are changing the way management and shareholders regard risk and the places they look to find it. The result is a fundamental change in the nature of risk management. These major shifts include:

- corporate globalization, especially into developing markets, that opens companies to a host of new political, health, and other risks;
- the rising importance of intellectual versus physical capital, creating a need for risk management in such areas as branding, information security, and privacy;
- more exposed supply chains, particularly as companies outsource many business functions once performed in-house; and
- just-in-time inventory systems that stretch supply chains thinner and thinner, leaving them more vulnerable to disruption from a hurricane, a strike, or even a terrorist attack.

Many, if not most, of the new risks can be attributed to the “Law of Unintended Consequences”: the unexpected byproducts of a two-decade explosion of new businesses, new markets, computerization, and gains in efficiency.

While these changes have propelled vast economic growth, they have also created new risks and magnified old ones. And risks that directly affect the firm can be distributed outside as well as inside its organizational—as well as its national—boundaries. For example, many large companies, such as airlines, are outsourcing various business functions, creating a network of intimate vendor relationships that can number in the thousands. A disruption anywhere in this web of interconnections holds the potential to disrupt—or at least weaken—the entire business structure, much like removing one card from a house of cards.

Another element common to the new generation of risks is that some are either uninsurable or still years away from the availability of an affordable, well-structured insurance product. Take, for example, damage to a firm’s reputation from acts or omissions real or alleged. That “intangible” damage can cost millions or billions in shareholder value, but there is no standard insurance policy to cover that loss. The bottom line? Many of the new risk categories are not transferable. Companies—with

the help of their risk management professionals—must manage their financial consequences by other means.

Such risks are becoming more important to corporate boards, shareholders, and outside analysts. Until recently, risk management was not a major area of interest for these groups—in part, because the stock market itself tends to focus only on short- to medium-term financial results, whereas risk management is more about preventing future problems. Where analysts did pay attention was largely in the area of financial risks—for example, at companies that use large amounts of oil or natural gas and need to hedge against sudden price fluctuations.

One reason is that analysts have always found it difficult to assess a company's risk "performance" since no commonly accepted set of measurement criteria exists. Some guidelines are being developed, such as the Australian/New Zealand 4360 Risk Management standard, those appearing through the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and the Basel II international capital framework initiative. And the fact that this development is taking place on several fronts underscores the problem of resolving them into a single set of criteria.

Risk management is becoming more important as a factor for analysts at credit-rating agencies.

Most buy-side investment analysts interviewed for the *Excellence in Risk Management III* survey, however, said that although a company's risk management program does not play a significant role in their rating processes now, it would in the future if more formalized methods of evaluation become available. And some analysts specifically noted globalization as a factor forcing them to pay closer attention to risk. For example, more companies today are developing offshore relationships, moving parts of their manufacturing and supply chains—as well as back-office and customer-service operations—to developing countries.

In preparation for this greater scrutiny by analysts of a company's risk management practices, risk managers, the C-suite, and boards of publicly held companies should be asking themselves three key questions that analysts may soon be asking:

- Does the firm's senior management know how much it is prepared to lose from all sources of risk over a given horizon (often a reporting period, but also over shorter horizons) to achieve its overall long-term financial objectives?
- Does the firm's senior management know where the top exposures are, both in terms of measured risks and unmeasured uncertainties?
- Is there an adequate understanding of the profile and mitigation of the potential losses from the top exposures?

Companies unable to answer all three questions with a resounding and unqualified "yes" may find themselves in disfavor with investors.

Risk Manager as Change Agent

The new risk environment has created opportunities as well as challenges for the risk manager. The opportunity is to better serve the CFO, the CEO, and ultimately the board by analyzing critical issues and bringing them to the attention of the C-suite before they become major problems. The challenge is that the new environment includes new areas, such as climate change and transparency, that the CFO—not to mention the board—will have to address before crises develop. If the risk management function does not take the initiative, other officers of the company—most likely those in finance-oriented positions—will.

Strategic risk management today means leading, not merely responding to events or demands from senior management.

It means pushing to play a role in managing every aspect of the evolving risk environment, becoming a change agent rather than merely a caretaker of the “traditional” risk management areas.

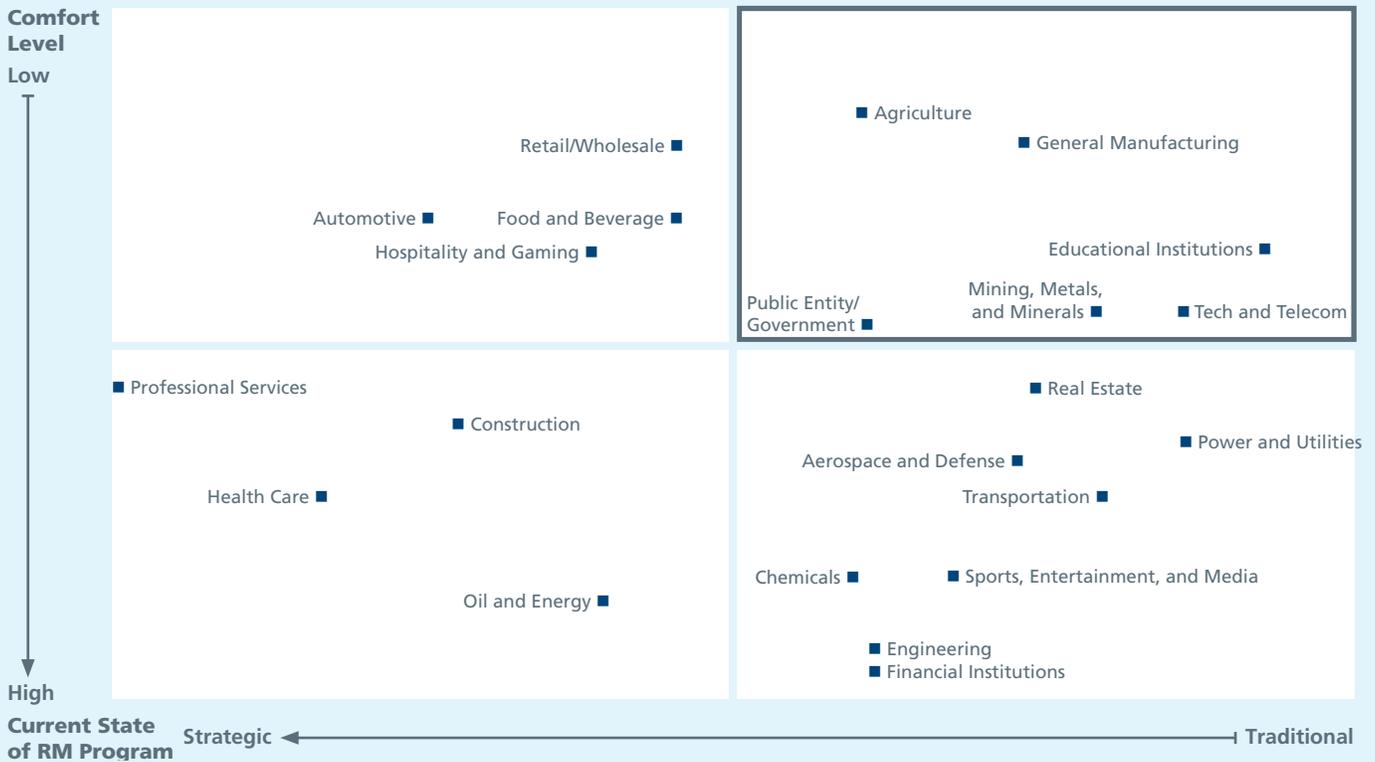
It means maintaining a time horizon one to three years into the future, rather than just operating from one month to the next, and a corresponding ability to manage crises—to identify the “incoming SCUD missiles” that could jeopardize financial performance and scuttle management’s plans. A progressive risk management practice may tackle some aspects of the new environment, but not in as proactive a manner. Usually, the progressive risk manager reacts when management calls rather than acting on his or her own initiative.

To be strategic, risk management must be proactive—be among the first to see the incoming SCUD—thus, developing the additional credibility that prompts senior leadership to consider risk management as a larger-scale change agent.

With the shift in risk environment, however, some industries may be more directly or immediately affected by new risks and, accordingly, be more inclined to find new opportunities in taking a strategic rather than a traditional approach. The *Excellence in Risk Management III* survey analyzed these differences by measuring companies’ comfort levels with their

current programs against how advanced they regard themselves to be in their risk management practices. The study then aggregated the findings by industry. Those encountering the greatest opportunity for developing and broadening their risk management capabilities appear in the upper right-hand quadrant of the following graph.

Comfort Level Versus Current State of Risk Management by Industry



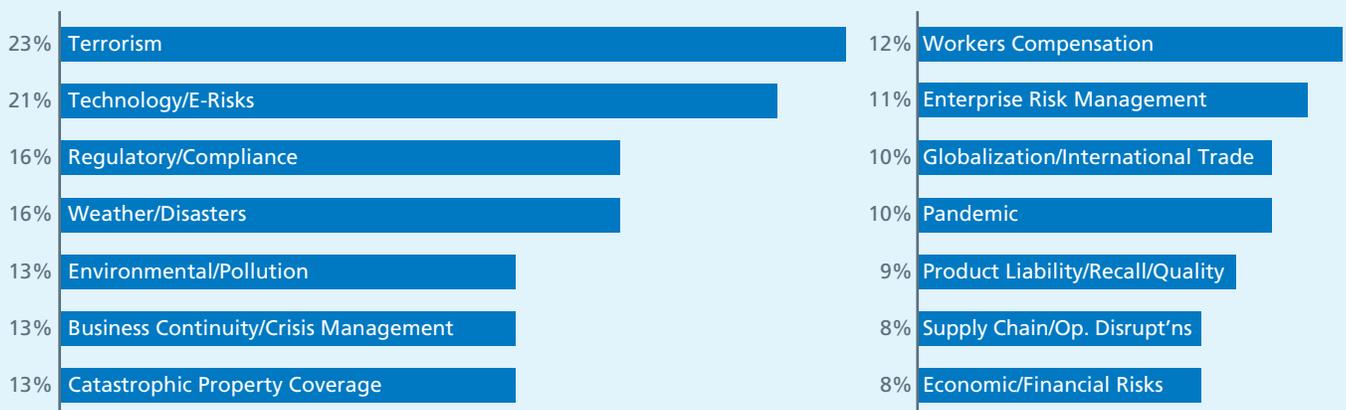
Future Shifts in Priorities

The *Excellence in Risk Management III* survey showed dramatically the shift in priority among risk management functions—in particular, where future opportunities to add value are likely to be found. Comparing future importance to current status of various risk management functions, respondents found far less potential value added by claims analysis, insurance, and other risk-transfer methods than, for example, by developing a communication and education plan for risk management. This likely indicates that companies feel they have mastered the traditional functions and expect to concentrate on other areas for future refinement and improvement.

Emerging risks like terrorism, weather disasters, and environmental issues are prompting companies to hone their ability to deal with crises and keep operations going in the face of catastrophe.

In the RIMS/Marsh survey, 63 percent of companies said they are currently using outside advice—and 42 percent plan to increase the use of external advisors—for business continuity and crisis management. Another 44 percent said that while they are not currently using outside advice, they plan to seek it. Respondents also put homeland security, terrorism, and matters related to the Terrorism Risk Insurance Act (TRIA) at the top of their list of emerging concerns over the next five years, with 23 percent mentioning these areas. Almost as many—21 percent—mentioned technology and e-risk, while 16 percent cited regulatory compliance.

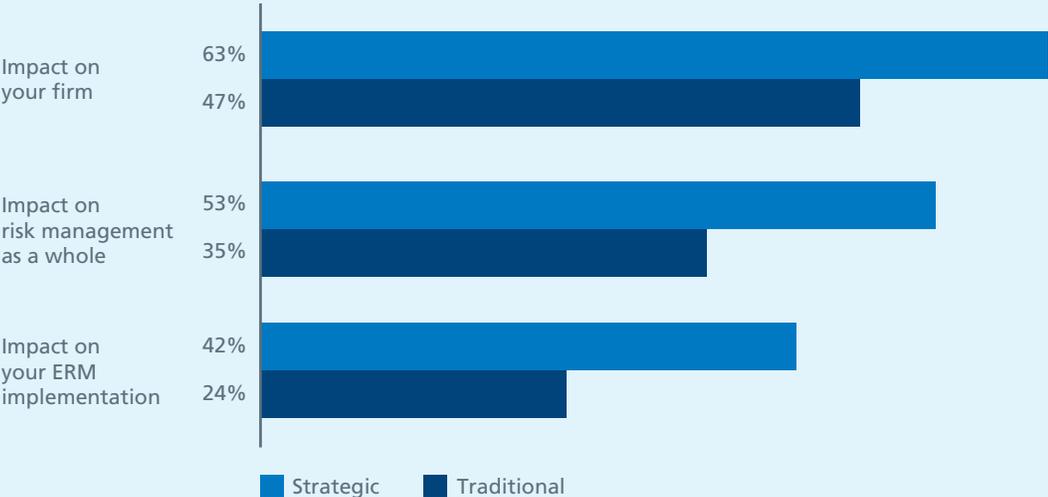
Risk Managers' Prioritization of Emerging Risks



Companies with a strong strategic focus are finding more positive aspects to implementing the Sarbanes-Oxley (SOX) rules, especially on their risk management efforts. Analysts caution against drawing too strong a connection here. One analyst said, “You can’t pass a law to make them practice risk management.” Nonetheless, 63 percent of survey respondents with a strategic focus said SOX has had a beneficial effect on their companies, and 53 percent said it has had a positive impact on risk management as a practice.

“There have been a lot of negatives, mostly related to the excess workload, but in the end, Sarbanes is all positive.”

Positive Impacts of Sarbanes-Oxley

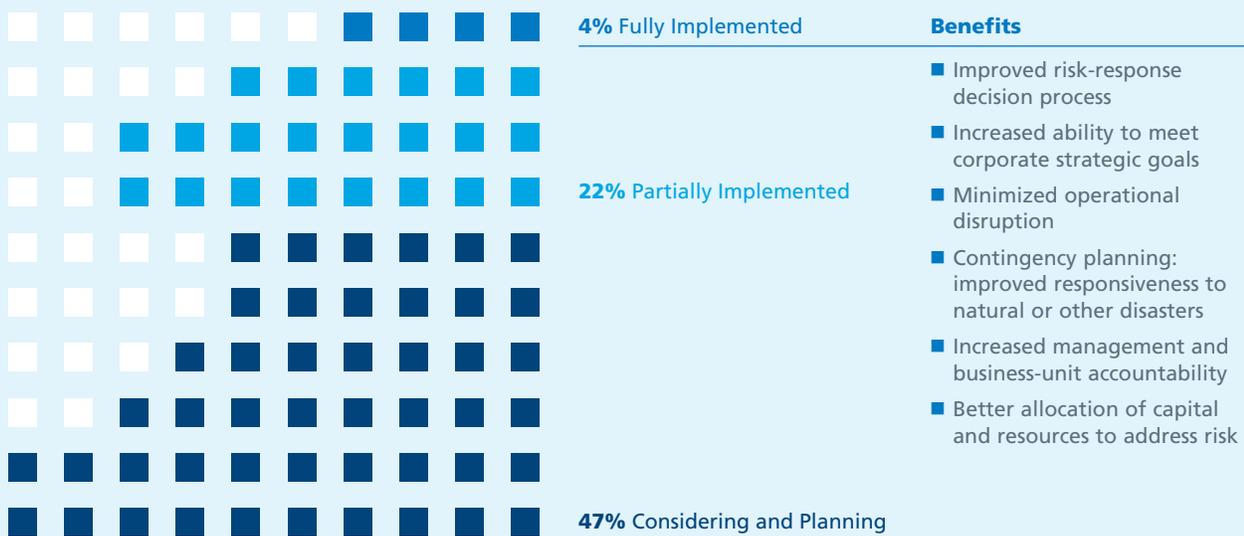


“SOX has had a positive impact because once people have gotten beyond the internal controls issues, they (CEO/board members) are asking questions about broader risk management issues of the company.”

The *Excellence in Risk Management III* survey also found that ERM efforts are more prevalent today among companies with big brands and a strong awareness of the risks posed by intellectual property, human capital, technology, and e-risk than among those holding more traditional notions of risk.

Larger companies are also further along with ERM. Twenty-nine percent of those reporting \$1 billion-plus in annual revenues said they have fully or partially implemented ERM, versus 22 percent of companies with less than \$1 billion. Twenty-seven percent of respondents said their companies are not considering ERM. Overall, however, 4 percent of companies said

ERM Implementation Status



they have fully implemented ERM, 22 percent have partially implemented it, and 47 percent said they are considering or planning to do so.

One reason more companies have not implemented ERM already may be the lack of a consistent, commonly accepted set of metrics for measuring its success—or, indeed, quantitatively assessing risk management performance in general. TCOR attempts to measure the organization's total cost of dealing with the risks it faces by combining the cost of its insurance premiums, its retained losses, and certain other expenses for the traditional lines of coverage: workers compensation, property

insurance, commercial general liability, and the like. Several years ago, TCOR was widely thought to offer a useful measurement, and 47 percent of respondents to the RIMS/Marsh survey said they perform this analysis. But most companies have found it too narrow. The result is that assessing ERM's value to the company is still difficult.

The risk management practice has not always been directly engaged in companies' ERM efforts. The impetus to put an ERM process in place generally comes from the board, with the CEO and CFO serving as conduits into the organization itself. Risk management may only be one of several areas asked to respond to the need for ERM. In many cases, the controller or the legal officer takes more of a lead.

Yet management at many companies is ambivalent about ERM itself. While it can make the company's operations more transparent, there is concern that this can change the definition of what the company needs to disclose as being material—in effect, extending the definition of corporate liability to risk issues.

At the same time, SOX, with its more stringent audit requirements, appears to be increasing the impetus to launch new ERM efforts or accelerate existing ones. One reason may be that ERM helps to demonstrate that the company is exercising good internal controls and documenting them.

Finance Officers' Views of Risk

Subsequent to the *Excellence in Risk Management III* study, Marsh asked Greenwich Associates to “round out” the findings with the perspectives of some finance officers. Interviews with 15 CFOs and other corporate finance officers embraced a cross-section of businesses ranging from giant aerospace and health care companies to an automobile dealership franchiser and a heavy equipment manufacturer to a real-estate investment company and an international engineering firm. Even the interview with the smallest firm revealed a range of concerns about risk that reached deep into the organization and projected ahead to concerns that have as yet to materialize, but that are expected to be on the radar in the next several years.

From large, publicly traded companies to smaller, privately held enterprises, finance officers today are broadening their awareness of risk and looking for better ways to manage it across the organization.

Some CFOs are effectively becoming chief risk officers as well, developing a strategic view that goes beyond the categories traditionally grouped under risk management and inaugurating efforts to educate from key executives down to the business-unit level. Nevertheless, most concede that they have no formal ERM program in place or else are only just starting to create one.

Procurement, service delivery, and supply-chain-related issues were among the common worries for global companies, especially those that have recently acquired other businesses or expect to do so. Pandemics, such as the avian flu, and competition with China were also cited by some of these companies, while those with largely domestic interests cited terrorism and recovery from weather-related catastrophes. High-tech companies and those with knowledge-based brands cited concerns about recruiting enough highly skilled and educated employees to maintain their competitive advantage in coming years. A manufacturer of automobile parts, not surprisingly, mentioned labor relations as its biggest area of potential risk.

Many of the companies, both large and small, have recently experienced rapid growth. Many of these said they worried about the potential of their larger—and sometimes more global—profiles to expose them to new risks, such as failure to maintain tight operational control and extend it to the new units. These companies also expressed concern about their ability to

retain key employees should rapid growth erode the corporate cultures they've built up over the years or the new ones they're attempting to integrate. One said the company has retained consultants on workplace environment and cultural diversity to deal with these issues. Another common worry was information security, especially data the companies collect about their customers.

Several older companies mentioned pension and health care costs as major emerging risks. How to deal with risks that involve promises of future benefits is a strategic issue, and some of the biggest concerns voiced by large companies involved other strategic risks. These included placing the right research and development "bets" and satisfying shareholders' worries about the pace of the company's organic growth and its response to cyclical events like interest-rates shifts and downturns in government spending on defense and homeland security.

Nearly all finance officers interviewed felt their companies were doing at least a satisfactory job of anticipating and responding to major risks, and most had procedures in place for the audit committee to receive regular enterprise-wide risk assessments.

On the other hand, few felt their companies were devoting enough resources to risk-related issues. At one large multinational, an official said the company does not devote enough resources to strategic risk. He also complained that while the company is good at monitoring risk within silos, it is not good at managing risk across the organization. And an official at a large chemicals company said it should be aiming more resources and personnel at risk assessment and measurement.

How they attempt to address these deficiencies depends a lot on the company's size and configuration. Large companies—especially those with diverse or geographically dispersed business units—stressed the need to educate key personnel about risk and designate "risk owners" in each unit. One company, which has experienced a large amount of litigation recently, incorporates risk training in its "Internet university," especially with regard to areas that could leave the company open to lawsuits.

At another company, a maker of food products, the finance officer says the various departments are their own "quasi risk managers." The commodity operations group is responsible for hedging risks related to raw materials, packaging, and energy procurement. The treasury side is responsible for hedging risks related to foreign exchange and interest rates, as well as insurable risks like directors and officers liability, property, casualty, and workers compensation.

Raising Risk Consciousness

"In our strategic plan, I see better mapping of risks and risk-mitigation strategies. I see that as kind of raising consciousness everywhere in the organization."

— Finance officer at an international engineering firm

Smaller companies were more likely to depend on their insurance brokers as informal risk advisors; some even demand this service.

“They have to have value-add in the proposition,” said the finance officer at a chain of auto dealerships. “If they’re just there to buy insurance for me, that’s just a necessary evil.” Larger companies saw this relationship differently: While even some large companies regarded their insurance brokers as trusted advisors, they added that they prefer to keep the needed expertise on risk management in-house—especially as this role has expanded to include such strategic issues as emergency response, crisis management, and business continuity.

One difference in the CFO and the risk management perspectives is their respective views of SOX. As already noted, risk managers felt that SOX has had a positive impact on risk management. The finance officers interviewed consistently played down the importance of SOX in a risk management context, although smaller companies complained about the resources needed to meet its reporting requirements.

Larger companies were more inclined to find some positive effects from the increased documentation and decision-making oversight that the law mandates; however, one noted that SOX has made management more aware of risks at its offshore captive insurance unit. “It has helped [our insurance] underwriters feel more comfortable,” a finance executive at a food manufacturer said of SOX. “Our name already has a great reputation behind it, but just demonstrating further the controls and procedures that we have in place, as well as the awareness within the company, is extremely favorable in the results we get from the marketplace.”

On the other hand, finance executives at one large and one small company used virtually the same language in pointing out that the rules of SOX are mostly about process—specifically, the underlying processes that drive financial statements. As such, they perceive SOX as addressing only one small part of what companies now regard as ERM. “You can get all the processes right, but still not be in control,” said a finance executive at a real-estate investment company with international reach.

SOX, then, is not enough to drive many companies to adopt a true ERM program. An executive at one major aerospace company said it has no unified ERM program, but rather makes identifying and responding to risks the responsibility of the people in charge of its various functional areas and business units. One large company is considering hiring a high-level, dedicated, enterprise-level risk officer. Another, a telecommunications giant, is “in the throes of deciding” whether to institute an ERM program, but the finance executive expressed some wariness, stating that ERM is a “buzzword” without a common definition that fits all the companies that profess to follow it. And while he believes his company needs better enterprise-wide risk oversight, he worries that too much could simply create more bureaucracy.

A common thread through many of the interviews, however, was increased scrutiny of risk from the C-suite and more direct involvement by the CFO—often on a higher strategic level than has traditionally been the province of the risk manager. The CFO at a large chemicals company, for example, expressed frustration that risk managers do not always regard insurance pricing as one of the areas for which they need to take some measure of responsibility.

According to a finance executive at a large equipment manufacturer, successful risk managers are very proactive and bring issues to the CFO so that these issues become front and center. Another saw the enterprise-wide risk manager's role as being a “translator” between the C-suite and key personnel within the company's functional areas and business units, while educating the latter to identify and understand the risks for which they have responsibility.

‘If you can't speak the language of the people at the top, you're stymied,’ he said. ‘You have to be able to look and say what is on their agenda, what is important to them, and then try to figure out that bridge from risk management to the CFO.’

At the same time, given the seemingly ever-widening range of risks, it's important to listen to people within the business units, understand their systems, and be knowledgeable about their business. In so doing, the risk manager can identify issues early and develop strategies ahead of time to deal with them.

Insurance Cost as Risk

“The insurance industry is a very cyclical industry, and it drives me nuts when I hear risk managers complaining because the market gets hard and they act so surprised. That's a risk that has to be managed just like any other risk.”

— Finance officer at a large chemicals company

Conclusion

The risk management practice occupies a central place in a business environment undergoing major change. The practice itself is changing as new disciplines such as business-continuity planning, evolving metrics, and ERM enter the risk management playbook. New vulnerabilities are evolving out of lengthening supply chains, increasing use of outsourcing, globalization, natural disasters, and the ever-looming threat of terrorism. The world of risk is expanding, making risk management a more complex field than ever.

At the same time, these very visible threats are forcing the C-suite, the board, and investors to focus more attention on risk management than they have in the past. For individual risk managers, this new environment represents the opportunity to play a far more prominent role with senior management than they have traditionally held. But the new and far broader portfolio of risks is fraught not only with opportunity, but also with the challenge to assert leadership in a complex and rapidly evolving field.

There will always be a need for the functions of traditional risk management and progressive risk management. But today's risk management professionals must step up to the plate and fill the bigger need for strategic risk management—or stand by and watch someone else fill that role.

Recommendations

Risk managers face a changing and increasingly complex environment: Senior management and the board need help in making the best risk decisions. Risk managers can play a vital role; but to do so, they must develop new skill sets and exhibit the competencies that will encourage management to turn to them rather than to others inside or outside of the company. The following are some recommendations to help you place yourself in the role of risk advisor to the C-suite:

- **Conduct a self-evaluation or internal focus group** between the risk management function and key partners to discuss the current state and direction of your risk management program. How is your company-specific risk management demand curve developed? What are your emerging risks? What are the gaps between current capabilities and likely future needs?
- **Develop a financial skill set at a high level**, especially in such areas as intellectual property and branding.
- **Resist the temptation to insulate yourself** from the rest of the organization. Risk management, going forward, will be concerned with every aspect of the company's operations and strategic planning. Reach out and develop understanding and strategic relationships.
- **Learn how to communicate effectively** with each area of the company exposed to some aspect of the risk portfolio. This will likely mean communicating with virtually every area of the company.
- **Know where your company is situated** on the path to understanding and addressing each new area of risk. Make it your responsibility to push your company forward along each of these paths.
- **Learn to lead!** The new risk environment has created an array of new concerns that require management's attention. Your job is to influence management's decisions in these areas, not merely respond to demands for action.
- **Develop a succession plan:** You are working within and helping to define a new and different function within your company. Plan now to develop a cadre of professionals who have the same skill set and understanding of the company that you do.
- **Begin preparations for more inquiries by third parties** on your organization's risk profile and response capabilities. How well is your leadership prepared for these questions?
- **Use this survey as a discussion point** and an education tool to draw out C-suite and board members on risk management direction and risk appetite.

The Risk Manager— New Skill Set

“Risk managers today are not going to be able to sit in that seat five or ten years from now unless they have a totally different educational and skill-set background. The financial background will have to be much stronger. If they don't have the strategic and financial background, they are not going to make it because they won't fit in the boardroom.”

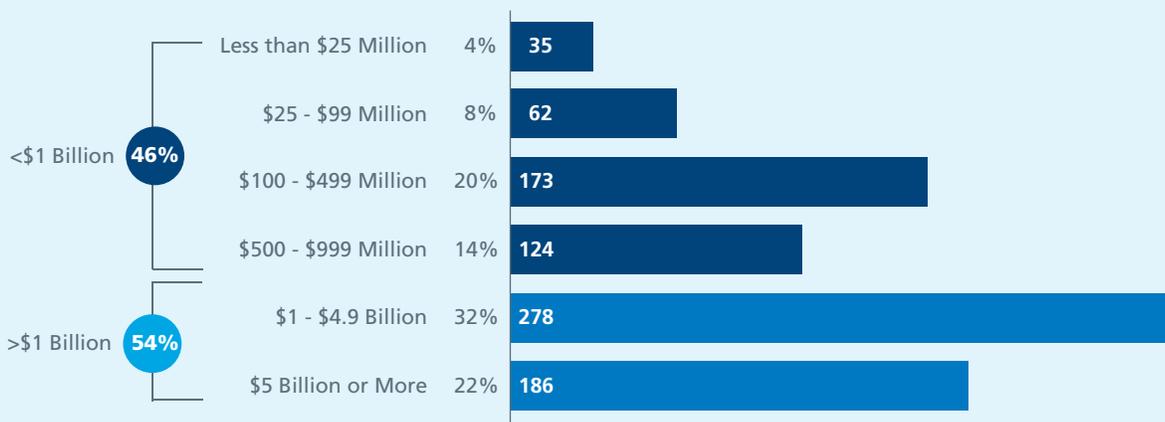
— Quote from one of the risk managers involved in the *Excellence in Risk Management III* survey

Appendix: The Survey Population

The findings in this report are based on 164 telephone and 702 Web-based interviews with risk managers who are members of RIMS. The 866 respondents represent a wide range of industries and considerable variation in their levels of experience in the field of risk management.

Annual Revenues

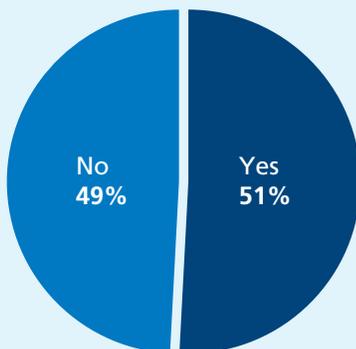
In looking at the firms in this survey, we divided them into six revenue groupings—four with revenue less than \$1 billion and two with revenue of \$1 billion or more. There is fairly equal representation of what could be characterized as middle-market and large-market firms.



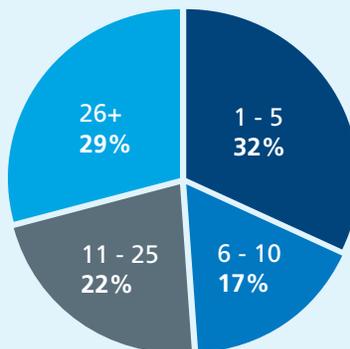
International Operations

Slightly more than half of the firms have operations outside of the United States, with slightly more than half of those firms operating in more than 10 countries.

International Operations?

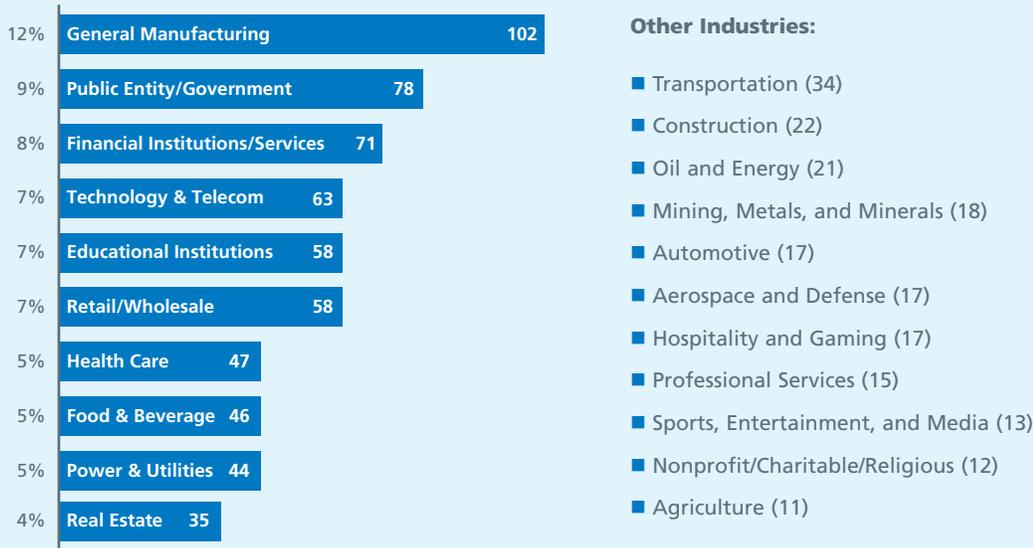


How Many Other Countries?



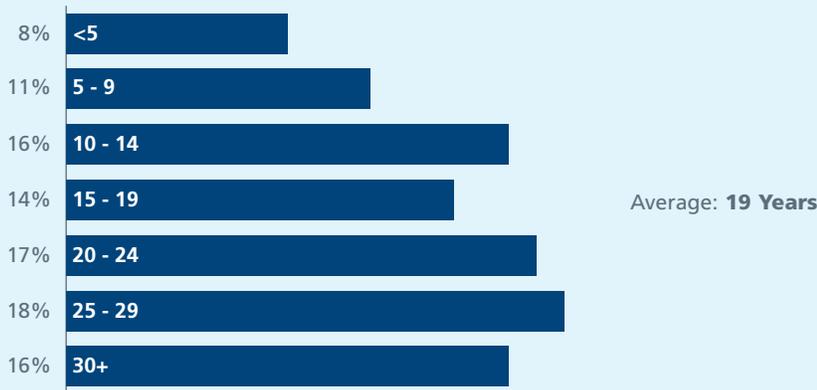
Industry Sector/Affiliation

Survey respondents also came from a wide range of industries.



Years of Experience in Risk Management

We asked respondents for the number of years in the risk management profession. The average number of years among all respondents was 19, with a low of less than 5 years and a high of more than 30 years.



About RIMS

The Risk and Insurance Management Society, Inc. (RIMS) is a not-for-profit organization dedicated to advancing the practice of risk management, a professional discipline that protects physical, financial, and human resources. Founded in 1950, RIMS represents nearly 4,000 industrial, service, nonprofit, charitable, and governmental entities. The Society serves over 9,600 risk management professionals around the world. For more information, visit the RIMS Web site: <http://www.RIMS.org>

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